

**REPORT ON THE
STATE POOLED INVESTMENT FUND**
For The Fiscal Year Ended June 30, 2010

PREPARED FOR THE
STATE FUNDING BOARD

December 15, 2010

PREPARED BY
TREASURY DEPARTMENT
CASH MANAGEMENT DIVISION

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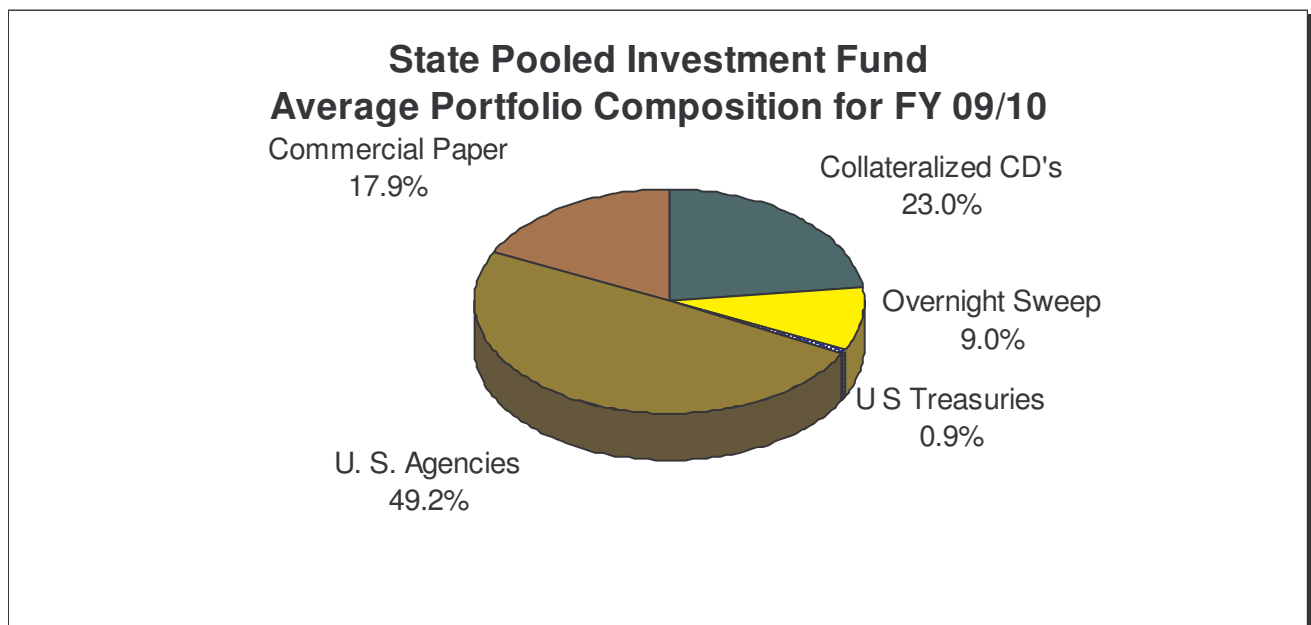
TENNESSEE TREASURY DEPARTMENT
State Pooled Investment Fund Report
For the fiscal year ended June 30, 2010

I. COMPLIANCE WITH INVESTMENT POLICY

The investment policy for the State Pooled Investment Fund is set by the State Funding Board. The board is composed of the Governor, Commissioner of Finance and Administration, Comptroller, Secretary of State, and Treasurer. The investment objective for the state pooled investment fund is to obtain the highest available return on investments consistent with the preservation of principal, while maintaining sufficient liquidity for state expenditures and other withdrawals from the state pooled investment fund.

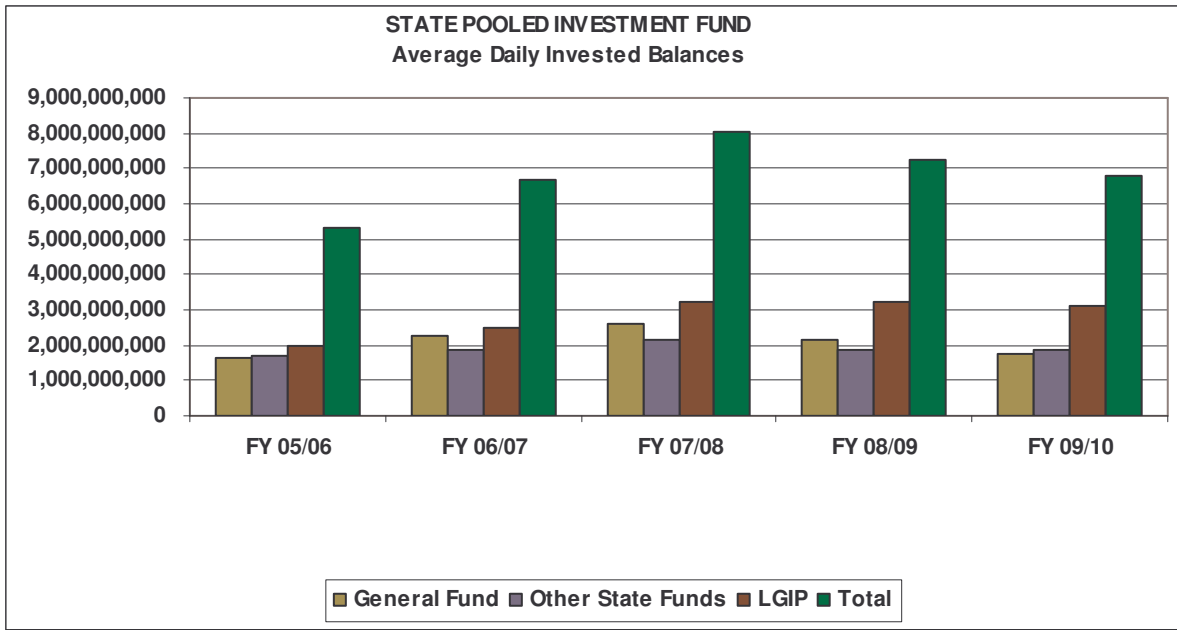
Portfolio Composition

The State Pooled Investment Fund had a monthly average of \$ 6.78 billion invested for the fiscal year ended June 30, 2010. The following chart shows the composition of the average portfolio.



Notice in the graph that the average invested in commercial paper during the year was 17.9% of the SPIF which is within the policy limitation (total of 40% of the SPIF, 35% up to 180 days and 5% overnight). The investment policy provides for investment in collateralized certificates of deposit as a priority over other investments to the extent in-state financial institutions want the CD's at the state's assigned rate. Typically, U. S. Agency securities are acquired instead of Treasuries when the yield spread makes them more attractive to own. This year, limited supply of other approved securities was the reason they were acquired.

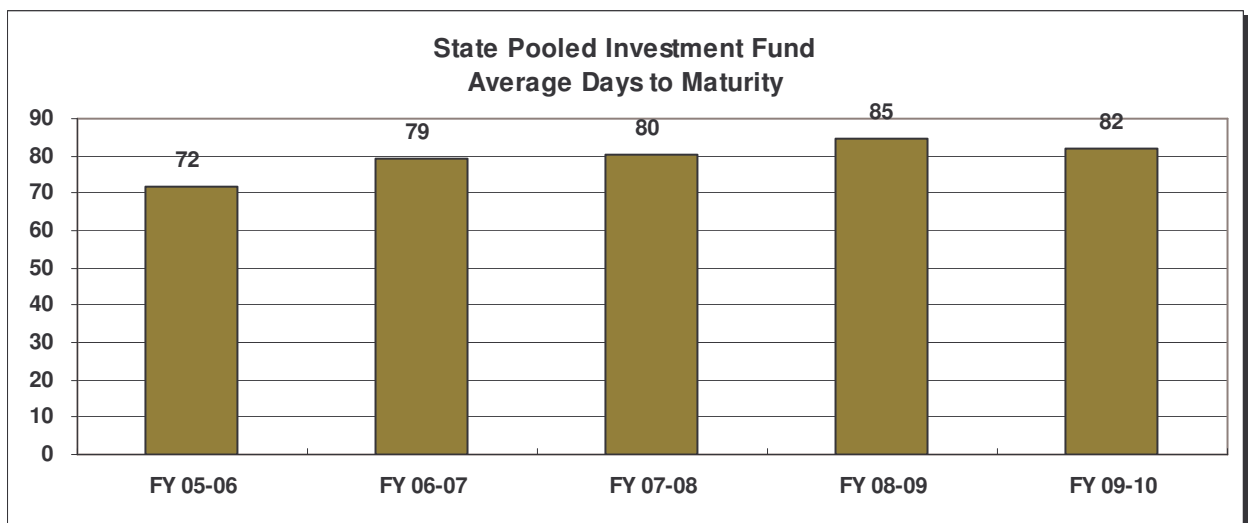
The following chart shows the average monthly balances in the state pooled investment fund for the last five years. At 6/30/10, the LGIP balance comprised 45.8% of the state pooled investment fund. The actual balance of funds available to invest on behalf of the General fund (Unrestricted Accounts) decreased \$610.4 million (25%) from \$2.42 billion for 08/09 to \$1.81 billion for 09/10.



Liquidity

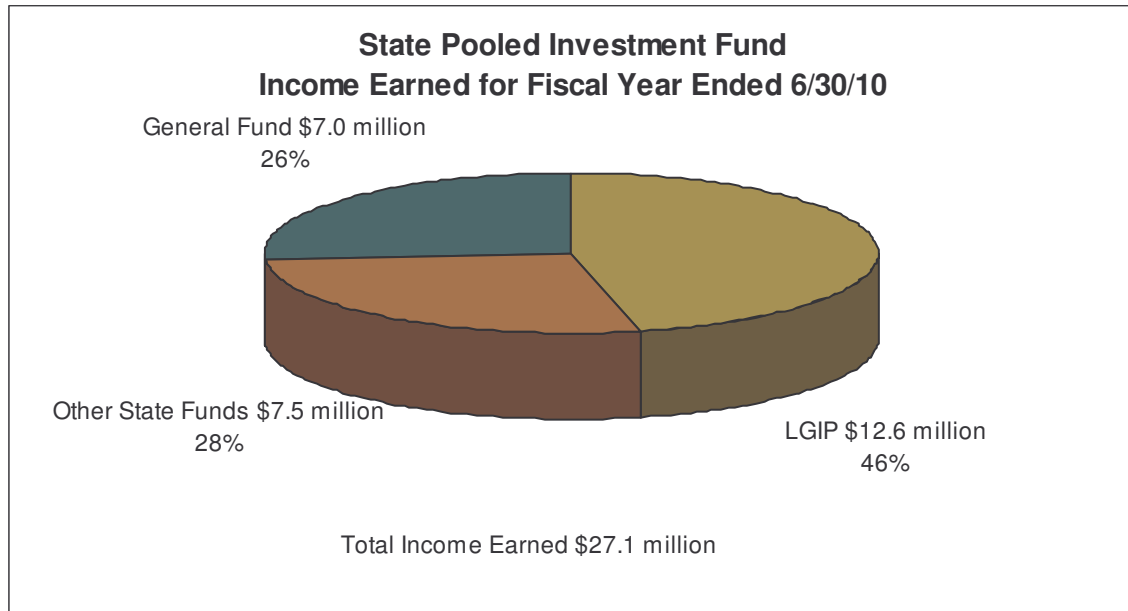
The Governmental Accounting Standards Board (GASB) issued a statement on “Accounting and Financial Reporting for Certain Investments and for External Investment Pools” (GASB Statement 31) which impacted the investment policy for the State Pooled Investment Fund (SPIF). The SPIF is operated in a manner consistent with the Security and Exchange Commission’s Rule 2a7 of the Investment Company Act of 1940. This rule requires a dollar weighted average portfolio maturity of 90 days or less and a maximum maturity of any single investment of 397 days or less.

The following chart shows the dollar weighted average maturity of the SPIF over the past five years.

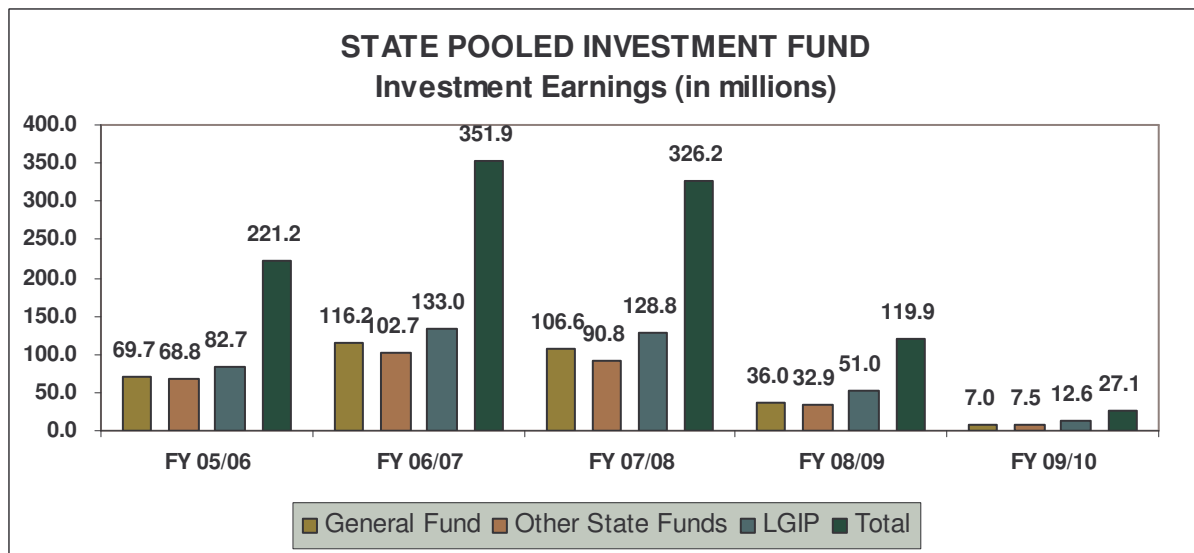


II. PORTFOLIO PERFORMANCE

Income earned on the portfolio during the fiscal year ended June 30, 2010 totaled \$27.1 million. The distribution of earnings as shown on the following pie chart was \$7.0 million to the General fund; \$12.6 million to the LGIP; and, \$7.5 million to Other State funds (accounts specified by statute, court order or regulation to receive interest earnings on their balances). Examples include the funds of TWRA, the Risk Management Fund, and the Group Insurance Fund.



The monies in the SPIF represent the liquid working capital available to the State of Tennessee to cover expenditures until additional revenues are collected. Earnings of the state pooled investment fund for the last five years are shown in the following chart.

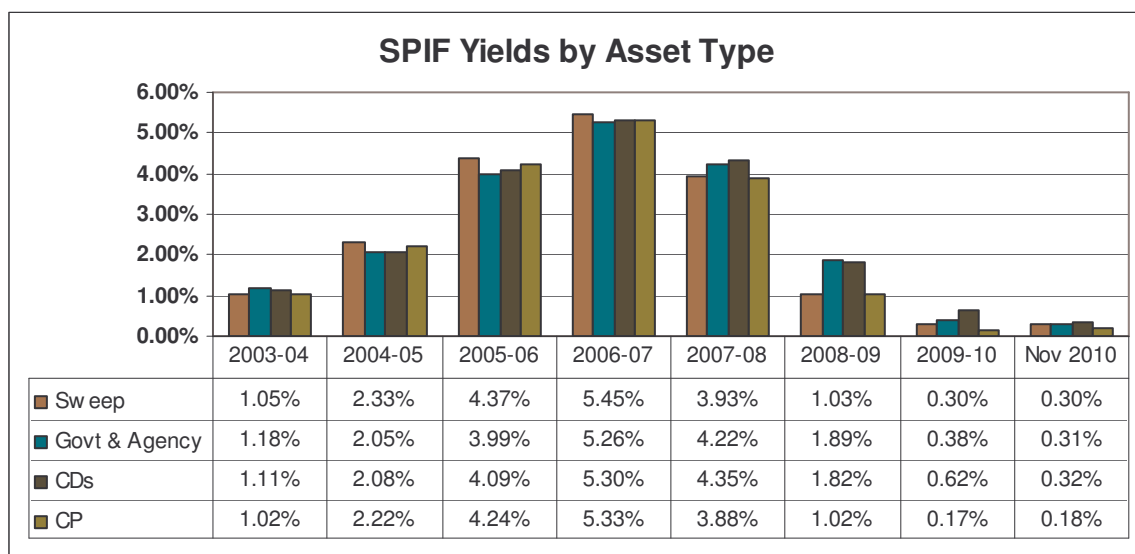


The fed funds target rate was lowered on 12/16/08 to a range of 0% to 0.25% and still remains at that level. The FOMC has given mixed signals recently regarding the timing of the next move in monetary policy, but

the futures market anticipates little change over the next 12 months. The chart below shows the actions taken at each of the meetings for the last eighteen months.

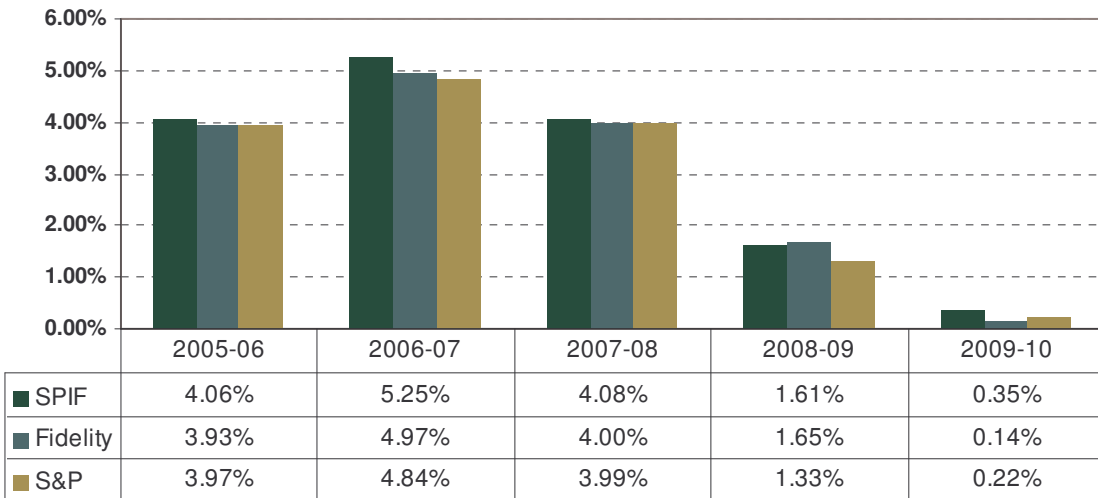
<u>FOMC Announcement Date</u>	<u>Fed Funds Target Rate</u>	<u>Direction</u>	<u>Amount of Change</u>	<u>Primary Credit Rate</u>	<u>Economic Assessment</u>
04/29/2009	0 to 0.25%	None	None	3.25%	Growth Risk
06/24/2009	0 to 0.25%	None	None	3.25%	Growth Risk
08/12/2009	0 to 0.25%	None	None	3.25%	Growth Risk
09/23/2009	0 to 0.25%	None	None	3.25%	Growth Risk
11/04/2009	0 to 0.25%	None	None	3.25%	Growth Risk
12/16/2009	0 to 0.25%	None	None	3.25%	Growth Risk
01/27/2010	0 to 0.25%	None	None	3.25%	Growth Risk
02/18/2010	0 to 0.25%	None	None	3.25%	Growth Risk
03/16/2010	0 to 0.25%	None	None	3.25%	Growth Risk
04/28/2010	0 to 0.25%	None	None	3.25%	Growth Risk
06/23/2010	0 to 0.25%	None	None	3.25%	Growth Risk
08/10/2010	0 to 0.25%	None	None	3.25%	Growth Risk
09/21/2010	0 to 0.25%	None	None	3.25%	Growth Risk
11/03/2010	0 to 0.25%	None	None	3.25%	Growth Risk

The following chart contains the average yields earned by asset type within the SPIF for the last five years and for the month of November 2010.

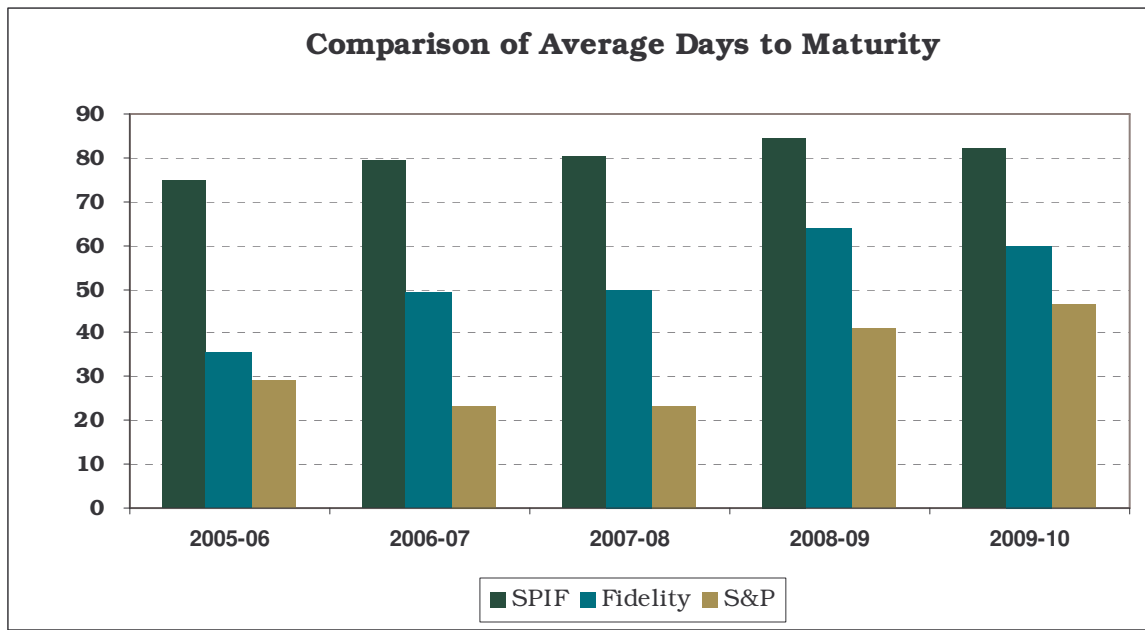


The State Pooled Investment Fund is actively managed within the Treasury Department. Standard and Poor's provides a rating service for LGIP funds and calculates an index return for the rated funds. The following chart compares the average yield of the SPIF (net of administrative fee) to that index and also to the net yield of a well recognized money market fund governed by SEC Rule 2a7, Fidelity Cash Reserves Fund.

Comparison of Yields Net of Fees



The following chart indicates how the average days to maturity of the State Pooled Investment Fund compares to the average maturity of the Standard and Poor's rated funds index and Fidelity Cash Reserves Fund.



III. INVESTMENT POLICY REVIEW

Staff has reviewed the current investment policy and may recommend changes at a later date based upon guidance from GASB regarding the newly adapted changes to SEC Rule 2a-7.

IV. INVESTMENT PLAN

Two years ago, the FOMC lowered the Fed Funds rate to a range of zero to 0.25%. The rate has remained unchanged since that time. Based upon Fed Funds Futures, the overnight rate does not change for at least a year, and does not get to .75% until May, 2012. This means that the earnings generated by the SPIF will be immaterial. Staff will continue to seek ways to generate as much revenue as possible and remain in compliance with the Investment Policy. Staff will continue to maintain a diversified portfolio of CDs, bank deposits, US Government obligations, and commercial paper. The yield curve, actions taken by the Federal Reserve Bank, and other market conditions will be considered when managing the asset mix and average maturity of the portfolio. Even though there have been many challenges in the current environment, the SPIF remains a safe investment for state funds and monies invested by local government officials. There has been no loss of funds due to credit exposure and no sales of assets required to generate liquidity.

V. COST OF ADMINISTRATION

The cost to operate the SPIF was \$3.526 million for the year ended June 30, 2010. The costs of operations are funded from a 5 basis point charge for assets invested. Most money market funds charge substantially more than 5 basis points. Also, the costs of operations include more than investment management. The 5 basis points finances:

- Investment of portfolio
- Maintenance of collateral
- Collateral pool administration
- Cash concentration
- Bank reconciliations and resolution of reconciling items
- LGIP program
- Warrant reconciliation
- Accounting and recordkeeping
- Support cost such as internal audit, payroll, personnel, etc.

VI. LARGEST HOLDINGS AT JUNE 30, 2010 BY CATEGORY

Treasuries and Agencies

1. FHLB	\$1,113,553,000
2. FNMA	878,696,000
3. FFCB	669,983,000
4. FHLMC	475,373,000

Commercial Paper

1. BNP Paribas	\$350,000,000
2. G E	300,000,000
3. Citigroup	100,000,000
4. Koch Industries	87,000,000

Bank CD's

1. B B & T	\$295,000,000
2. Fifth Third	230,000,000
3. Pinnacle	180,000,000
4. First TN	50,000,000